Q62

What is the importance of the term "Interest Coverage Ratio" of a firm in India? 1. It helps in understanding the present risk of a firm that a bank is going to given loan to. 2. It helps in evaluating the emerging risk of a firm that a bank is going to give loan to. 3. The higher a borrowing firm's level of Interest Coverage Ratio, the worse is its ability to service its debt. Select the correct answer using the code given below (a) 1 and 2 only (b) 2 only (c) 1 and 3 only (d) 1, 2 and 3 Official key: A.

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Explanation

(a) Official key

1 and 2 only. ICR shows present debt-service comfort and flags emerging stress. Higher ICR is better, not worse.

(b)

2 only. Present risk is also read from ICR.

(c)

1 and 3 only. Statement 3 reverses the ratio.

(d)

All three. Statement 3 fails.

Summary

Official key is (a) 1 and 2 only. Interest Coverage Ratio (EBIT / interest) tells a banker how easily a firm services debt now and how tight it may get. A higher ratio is better, not worse.

Related possible facts

These can be asked in a future Prelims paper.

ICR
EBIT ÷ interest expense.

DSCR
The cash cousin for term loans.